Do Nonprofit Organisations "Trade" Under The New Work Choices Legislation?

Introduction

The new *Workplace Relations Amendment (Work Choices) Act 2005* (Cth) is having a significant impact on all employers and employees, but its applicability to nonprofit corporations is unclear. The amended *Workplace Relations Act 1996* as a consequence now applies to a "constitutional corporation" which is in turn defined as a "foreign corporation, or a trading or financial corporation formed within Australia" as per paragraph 51(xx) of the Australian Constitution. The crux of the issue is which nonprofit organisations, if any, are "trading" corporations? The key dividing line for business organisations is whether they are "corporations" (rather than partnerships or trusts). Clearly, the vast majority of business organisations trade. For nonprofit organisations the dividing line will be both whether they are a "corporation" and whether they "trade".

As the scheme of the legislation is not optional, deciding whether a nonprofit profit organisation is within or outside the ambit of the new law is essential. Nonprofit organisations need to know whether the federal or state provisions apply, so they can act accordingly. Potential problems loom for a nonprofit organisation that makes the wrong choice in terms of employment contracts and agreements, employee payments and dispute resolution because the federal and state provisions differ.

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The High Court by a 5-2 majority has upheld the constitutional validity of the legislation by a reliance on the corporations power.[1] The Court did not address the issue of the definition of 'trading corporation' in relation to nonprofit organisations. Nonprofit board members and management are faced with the decision of whether their body is a trading corporation for the purposes of legislation. If they make the wrong decision, then some time later they may face the prospect of unwinding the consequences.

This is an issue of national proportion as in 2002, the Australian Bureau of Statistics estimated that over 35,000 nonprofit employers engaged about 604,000 people constituting 6.8% of the Australian workforce.[2][3] In 1996, there were approximately 700,000 nonprofit organisations, of which 320,000 were incorporated (by way of comparison ASIC has about 1.5 million registered corporations).[4] Incorporated legal entities commonly used by nonprofit organisations include companies limited by guarantee under the *Corporations Act* and incorporated associations and co operatives under each state and territory jurisdiction. Other less common corporate forms include royal charters, letters patent and various state and federal statutorily created nonprofit corporations. All of these corporate legal forms will fall under the definition of 'corporation' for the purposes of the Act. Charitable trusts and unincorporated associations are not corporations and will not fall within the provisions.

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[1] New South Wales v Commonwealth of Australia [2006] HCA 52
[2] ABS, Non-profit Institutions Satellite Account, Australian National Accounts 1999/2000. Cat No. 5256.0, Canberra, 2002.
[3] ABS, Non-profit Institutions Satellite Account, Australian National Accounts 1999/2000. Cat No. 5256.0, Canberra, 2002.
[4] Lyons, M, *Third Sector: The contribution of nonprofit cooperative enterprises in Australia*, 2001, Allen & Unwin, NSW.

But how much 'trading' do nonprofit organisations do and is it significant? In 1999/2000 the Australian nonprofit sector's main sources of income were as follows:

- 58% - sale of goods and services
- 30% - government grants and contracts
- 9% - Household transfers (fundraising etc)

This is one of the highest percentages of sale of goods and services in the OECD and clearly points to what would ordinarily be described as 'trading'.[5] These are aggregated figures across the whole sector of nonprofit organisations and there are variations within sub sectors, for example, overseas aid organisations have very little sale of goods and services whereas cultural organisations have significant amounts. The big picture tells us that the Australian nonprofit sector as a whole does engage in what would be commonly regarded as a significant amount of trading activity. However, whether an individual nonprofit corporation for the purposes of the *Workplace Relations Act 1996* is a 'trading corporation' requires far more consideration.

In 1909, the High Court clearly regarded nonprofit organisations as not falling within the definition of "trading corporation" Justice Isaacs in *Huddart Parker & Co v Moorhead* stated that "Excluded from the designation of financial and trading corporations would be all those domestic corporations, for instance, which are constituted for municipal, mining, manufacturing,

[5] Lester Salamon et al, Global Civil Society. Dimensions of the Nonprofit Sector, Center for Civil Society, Johns Hopkins University, Baltimore, 1999.

religious, charitable, scientific and literary purposes….". [6] However, over the last thirty years, the High Court has expanded the power of the Commonwealth in respect of this head of power and many nonprofit organisations have been classified as "trading corporations". It has been a shift from primarily considering the 'formal object and reason for establishment of the corporation' to 'the actual activities of the corporation'. It is finding out exactly where the activity dividing line falls that will interest boards and management of nonprofit corporations.

This paper will trace the expanded scope of the trading definition by chronologically examining the recent leading cases involving nonprofit corporations. It seeks to identify the developing themes of trading and non-trading classifications over this period in order to establish some critical factors in determining which nonprofit organisations fall within the definition of constitutional corporation.

What is a Trading Corporation?

WA National Football League (Adamson Case) (1979)

In the High Court case of *R v Federal Court of Australia; ex parte WA National Football League* (1979) 143 CLR 190, the majority of the court found both the Western Australian and South Australian Football Leagues to be "trading corporations." This High Court decision is significant because it marks

[6] (1909) 8 CLR 330.

the departure from merely examining the purpose of the incorporation of the corporation to rather the current activities of the corporation.

The objects of the WA and SA Leagues were to "promote, manage and encourage Australian Rules Football matches and competitions." As a result of this the Leagues received a substantial income from the matches, broadcasting fees, advertising, catering and other sources. Part of this income was retained with the balance being distributed to the member clubs. There was no dispute amongst the majority that "the presentation of a football match as a commercial venture for profit to the promoting body is an activity of trade."[7] Nevertheless, the majority judgments still differed in their opinions as to what a trading corporation actually is. Barwick CJ stated that "the description "trading corporation" must be given its full content, generously rather than strictly construed."[8] Trading must be "a substantial corporate activity" to satisfy the description of trading corporation. Barwick CJ conceded that whilst trade cannot be confined to dealing goods, it may be difficult to define its parameters.

Mason J, opined that - "Not every corporation that is involved in trading is a trading corporation. The trading activity of a corporation may be so slight and so incidental to some other principal activity, viz religion or education in the case of a church or school, that it could not be described as a trading corporation. Whether the trading activities of a particular corporation are sufficient to warrant being characterised as a trading corporation is very much

[7] (1979) 143 CLR 190, at 211.
[8] (1979) 143 CLR 190, at 207.

a question of fact and degree."[9] Mason J found that the concept of trading was not limited to buying and selling at a profit, and extended to "business activities carried on with a view to earning revenue."[10] Grants or funding by government for the encouragement of certain activities or even the delivery of welfare services was not be regarded as trading and not included in any assessment of how significant trading was in the particular situation. The fact that no amount of the club's revenue or profit could be distributed to members was also taken into account by Mason J, but was outweighed by other factors pointing towards it being a trading corporation.

Murphy J's judgment presented an even broader interpretation of a trading corporation - "Even though trading is not the major part of its activities, the description "trading corporation" does not mean a corporation which trades and does nothing else or in which trading is the dominant activity. A trading corporation may also be a sporting, religious, or governmental body. As long as the trading is not insubstantial, the fact that trading is incidental to other activities does not prevent it from being a trading corporation. For example, a very large corporation may engage in trading which though incidental to its non-trading activities, and small in relation to those, is nevertheless substantial and perhaps exceeds or is of the same order in amount as the trading of a person who is clearly a trader."[11] These comments by Murphy J proved to be a prediction of the attitudes adopted in later cases.

Australian Red Cross Case **(1991)**

[9] (1979) 143 CLR 190, at 235.
[10] (1979) 143 CLR 190, at 234.
[11] (1979) 143 CLR 190, at 239.

In *E v Australian Red Cross Society* (1991) 27 FCR 310, the Federal Court of Australia found the Australian Red Cross Society, the NSW Division of the Society and the Royal Prince Alfred Hospital to be trading corporations. The substantial activity of the Red Cross was held to be the supply of blood, free of charge. This activity was found not to constitute trade. However, trading was found to constitute a substantial and not merely a peripheral corporate activity. Approximately 4.4% (about $2 million in 1984-5) of the revenue of the society, and 15.6% of the revenue of the NSW Division of the society was raised through trading activities. About 16% of the Prince Alfred Hospital's income was the result of trading activities.

The judgment looked at the tests used in the *Adamson* case, of "substantial' and "a sufficiently significant proportion of its overall activities." Although only 4.4% of the revenue of the society arose from trading activities, this small percentage amounted to $2 million, which was a sufficiently significant proportion of the society's income.

Whilst the Prince Alfred Hospital was not formed with the purpose of becoming a trading corporation, the court decided that the formation motive of the corporation does not matter, it is its activities that are important. The court stated - "If the question be asked whether the scale of the corporation's trading activities was "substantial", "a sufficiently significant proportion of its overall activities" or "not substantial" – to apply the tests adopted in *Adamson* – it is relevant to note that, in the financial year ended June 30 1985 it received $14,584,456 in patients' fees in return for services rendered by it. It

also received $3,736,662 from “business activities.” It is true that these amounts were dwarfed by its state government subsidy of $112,127,706. But that does not matter. Trading activities yielding some $18 million per year can only be described as substantial. It seems to me that the scale of the hospital’s trading activities in 1984-5 was such that it should be regarded as then being a trading corporation.”[12]

Therefore, patients’ fees in return for hospital services amounted to trading by the Prince Alfred Hospital. Trading activities of the Red Cross constituted “donations from Branches which operate community shops, street stalls and other fundraising activities”, charges for attendance at its first aid courses, and income from its Clarence Street Gift shop. The definition of trading was clearly broadened to accord with Justice Murphy’s views in the Adamson’s case.

Kirinari Residential Services Case **(1996)**

Re Kirinari Residential Services (Vic) & (NSW) Inc (1996) 40 AILR 3-420 dealt with whether Kirinari Residential Services is a “trading corporation”. Kirinari offered residential accommodation and in-home services to people with disabilities. Only a limited proportion of Kirinari’s income was derived from client fees, with the government supplying the majority of its funds. The court applied the test used in *Adamson* and in *Red Cross*, that the trading activities must be “substantial” and not merely a peripheral corporate activity. The judge formed the view that the services performed by Kirinari were not “gratuitous.”

[12] (1991) 27 FCR 310, at 345.

Whilst Kirinari's services are heavily subsidised by the government, its service is not provided free of charge, with clients being charged a proportion of their weekly disability support pension. The Health Services Union of Australia (HSUA) submitted that a corporation cannot be found to be a trading corporation if it derives less than 20% of its income from trading activities. The *Red Cross* case was applied and Kirinari Residential Services was found to be a trading corporation.

Syd-West Personnel Case **(1998)**

A case that fell outside the definition of a trading corporation is Syd-West Personnel.[13] However, the decision needs to be treated with caution because it was a decision of a tribunal, rather than the High or Federal superior courts of record. It does give however a useful summary list of matters to consider in considering whether a corporation trades.

Syd-West Personnel was established to build and operate a long term employment program for individuals with intellectual disabilities, and additionally to place other workers in employment. Syd-West Personnel was found not to be a trading corporation in *Fowler v Syd-West Personnel Ltd* (1998) 44 AILR 3-836. The Australian Industrial Relations Commission found that over the years the courts have made it less difficult to show that a corporation is a trading corporation. A number of useful principles derived from the case law were listed as:

[13] *Fowler v Syd-West Personnel* (1998) 44 AILR 3-836.

1) The mere fact that a corporation trades does not make it a trading corporation (*St George County Council* case[14]; *Adamson*[15]);
2) The purpose of incorporation, propounded in St George is no longer a valid test. The test is one of the current activities of the corporation (*Adamson*; *State Superannuation Board* case[16])
3) But the current activities test is not the sole criterion for determining whether a corporation is a trading corporation. Thus where a corporation has not begun to trade, its character can be found in its constitution. Even when there are current activities, the corporation's constitution is not completely irrelevant (*Fencott v Muller*[17])
4) Views as to the necessary extent of the trading activity have varied. It must be a substantial corporate activity (Barwick CJ in *Adamson* p208); the trading activities must form a sufficiently significant proportion of the corporation's overall activities (Mason J in *Adamson* p233); the trading activities should not be insubstantial (Murphy J in *Adamson* p239); the corporation must carry on trading activities on a significant scale (Mason, Murphy and Deane JJ *in State Superannuation Board* p96)
5) An incorporated sporting body can be a trading corporation if its activities meet the required test (*Adamson*)
6) In particular, incorporation under a statute such as the Association Incorporation Act does not prevent a corporate body from being a

[14] (1974) 130 CLR 533.
[15] (1979) 143 CLR 190.
[16] (1982) 44 ALR 1; 57 ALJR 89, at 96.
[17] (1983) 46 ALR 41; 152 CLR 570, at 602.

trading corporation if its activities warrant that description (*Adamson*, p232)

7) Trading denotes the activity of providing, for reward, goods or services (*St George* case, p569-70)

The AIRC found that "[t]he essence of what SWP does is to use grants from the Department to operate its long term employment program for people with intellectual disabilities and, also, to place other workers in employment. It is engaged in, to use Wilcox J's words in the *Red Cross Case*, "the gratuitous provision of a public welfare service, substantially at government expense."[18] As Wilcox J said, this is not the conduct of a "trade"."[19] If Syd-West Personnel does trade, "its trading activities are sufficiently insignificant so as not to make it a trading corporation."[20] Therefore, whilst the courts have broadened the definition of a "trading corporation," it is still possible for an organisation to fall outside this definition where its trading activities are insignificant.

***Aboriginal Rights League Case* (1999)**

Belcher v Aboriginal Rights League Inc (1999) 45 AILR 4-045, concerned an application by Ms Belcher for unfair dismissal, but again should be relied on cautiously as it is a tribunal decision. She was an employee of the Elizabeth Hansen Centre, a nursing home for aboriginal seniors, run by the Aboriginal Rights League. This case also examined at whether trading formed a "significant" or "substantial" part of the organisation's activities, in order for it

[18] (1991) 27 FCR 310.
[19] (1998) 44 AILR 3-836.
[20] (1998) 44 AILR 3-836.

to constitute a trading corporation. Trading was not limited to buying or selling at a profit, but included the provision of services carried on for the purpose of earning revenue (as per Mason J in the *Adamson Case*). "Trading need not be the organisation's predominant or characteristic activity; however activities which are peripheral, incidental or insubstantial are not sufficient for the organisation to satisfy the definition."[21] The income derived from trading was found to be substantial in the same context as in the *Red Cross Case*. The removal from the total revenue of the income derived from trading activities would be "very significant" and thus the Aboriginal Rights League Inc is a trading corporation.

***Quickenden Case* (2001)**

The issue in *Quickenden v O'Connor* (2001) 109 FCR 243 was whether the University of WA is a trading or financial corporation. Identified examples of "trading" by the University included ticket sales, sales of publications and services, parking fees and fees and charges for overseas students. Black CJ and French J held that "[t]he University's activities other than the provision of educational services within the statutory framework of the Higher Education Funding Act are trading activities and are substantial in the sense of non-trivial, albeit not the predominant element of what the University does."[22] Carr J also adhered to the reasoning of *Adamson*, finding the University to be a trading corporation. "The University's provision of education under the Higher Education Funding Act is a trading activity. The

[21] (1999) 45 AILR 4-045.
[22] (2001) 109 FCR 243, at 244.

value of that activity and other services provided under contracts amounts to 18% of the total operating revenues of the university. This represents a substantial part of the operation of the university considered relative to the university's total income. Thus the university is a trading corporation."[23]

Orion Pet Products Case (2002)

In deciding whether or not the RSPCA was a trading corporation in *Orion Pet Products Pty Ltd v RSPCA* (Vic) Inc (2002) 120 FCR 191, Weinberg J referred to a number of the previous cases. The RSPCA was substantially involved in non-trading or non-income producing activities, including the protection, treatment and maintenance of the animals, the provision of shelter, and community education. However, Weinberg J submitted that "on any view, trading revenue in excess of $5.5 million was substantial, in the context of the overall revenue of the RSPCA."[24] Even though the RSPCA was funded largely by legacies, and without these legacies, the RSPCA would have had an operating deficit; it is still a trading corporation according to the case authorities. Weinberg J accepted "that trading on a modest scale does not imbue a company with the character of a trading corporation," but found the trading activities of the RSPCA to be "anything but modest."[25]

Educang Case (2006)

[23] (2001) 109 FCR 243, at 244.
[24] (2002) 120 FCR 191, at 218.
[25] (2002) 129 FCR 191, at 219.

The Queensland Industrial Court, again a lower court than the High or Federal courts, considered the application of the *Workplace Relations Act 1996* to a nonprofit religious school in *Educang Ltd V QIRC and QIEUE [2006] QIC 45.* President Hall found that although state and federal grants contributed about 43.4% (nearly $10m) of school income and should not be considered 'trading', the vast proportion of the other income was in the nature of trading. Activities such as tuition fees, full fee paying overseas students, uniform and book sales, canteens, vending machines and before/ after school care all contributed to trading income. Both the percentage of trading income and the substantial dollar amount involved led the State court to decline jurisdiction in respect of the School.

Are there any bright lines?

Nonprofit boards are generally risk adverse when it comes to abiding by the law of the land and their organisation's reputation is at stake. Establishing whether state or federal provisions apply to employment matters will be a difficult decision for some boards who will seek to manage their risk by relying on independent legal advice. Until the High Court places some authoritative guiding principles beneath the process of deciding whether any trading income is merely incidental and ancillary or a substantial undertaking, reliance will have to be placed on lower courts decisions.

If the nonprofit corporation has not commenced operations, the matter will be determined by an examination of its constitution, particularly its stated objects.

Those nonprofits that are operational will have to classify their activities into "trading" and "non trading" activities. Activities that have not constituted trading include the receipt of government grants, providing disability services (almost entirely reliant on government grants), and providing a donor blood transfusion service.

Activities classified as "trading" include: providing services in return for a fee or charge, selling goods from a shop or stall, international student fees, patient charges, fundraising activities, charging car parking fees, ticket sales and sales of publications, advertising and broadcasting, and charging for admission. Government grants and subsidies to nonprofit organisations are generally not regarded by the courts as trading income.

However, for a nonprofit corporation to be classified as a trading corporation, trading must be a "substantial corporate activity", or must be "sufficiently significant" and must not be "insubstantial." It is this determination which will prove difficult for many organisations. According to cases such as *Red Cross*, "substantial" and "sufficiently significant" can amount to a mere 4.4% of the revenue of the corporation. Where trading contributes to a relatively small percentage of a corporation's revenue, this may still be sufficient to classify the corporation as a trading corporation where a significant amount of money, such as $2 million in *Red Cross*, is involved. There is little indication of whether $1 million or $500,000 is substantial and what, if any, is the relationship between percent of revenue and gross amounts. The words "substantial" and "sufficiently significant" remain somewhat ambiguous,

though it does appear that over the years the courts have made it easier for one to show that a corporation is a trading corporation.

Bright lines could be produced by an organisation if it relinquished its corporate form and reconstituted itself as a trust or unincorporated association. Further, an organisation could separate trading activities into a separate, but controlled organisation so that the distinction was apparent and each entity would be more certain of its characterisation under the legislation. This currently occurs in England where charities must by law separately incorporate trading entities. However, the consequences of such separation for income tax exemption, fringe benefit tax liability and donation deductibility status let alone the inconvenience and extra compliance costs makes such an option viable in only the most extreme situations.

It is to be regretted that nonprofit boards with the other significant challenges that they face in funding their organisations, seeking to attract professional staff and volunteers in an increasingly competitive market and meeting the increasing demands of their stakeholders are dragged into largely unresolvable state-federal constitutional disagreements not of their making.